Why inequality matters

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There was a time, not long ago, when most economists did not consider inequality in the distribution of income and wealth all that important. True, in Scandinavia and Austria, for example, distributional issues were embedded in economic policy through "social partnership" from the 1950s onward on the conviction that an equitable income distribution would help to promote social peace. Elsewhere, it was commonplace to view inequality as the gratuitous preoccupation of bleeding hearts that did not really merit the serious attention of policy makers seeking to promote rapid economic growth without inflation.

Redistribution was widely considered to be detrimental to rapid growth. National statistical offices and international organizations, with the notable exception of the World Bank, hardly bothered to compile internationally comparable statistics on distribution. When they did, the estimates were incomplete in that they covered only wage income plus interest income, leaving out capital gains.

Insult was added to injury when it became widely known that vast amounts of wealth – and the income from that wealth! – have been kept, and remain, hidden in tax havens.

Squirrelled away

Recently, the French economist Gabriel Zucman reported nearly $6 trillion of hidden global household financial wealth, at the time (2008) equivalent roughly to ten percent of the world's total gross domestic product. These numbers reduce the reliability of official distribution statistics, suggesting that these may significantly understate inequality.

Since the early 1970s, the share of national income paid to workers in advanced economies has fallen from 55 to 40 percent. A declining labour share goes along with increased inequality in the distribution of income and wealth as well as health. Medical researchers report that the wealthiest one percent of American men live 15 years longer than the poorest one percent and that the wealthiest one percent of American women can expect to live ten years longer than their poorer counterparts. The gap is widening. Life expectancy in the US declined in 2015 and 2016 and may have done so again in 2017. If so, this will be the first time since WWI that US life expectancy has declined three years in a row. In the UK, life expectancy was the same in 2016 as in 2011. Iceland is not far behind, with life expectancy unchanged from 2012 to 2016.

Concerns about inequality have recently been thrust to the forefront of political discourse around the world. An important part of the explanation for the surprise victory of Donald Trump in the 2016 US presidential election is that he did well among those voters who felt they had been left behind with stagnant real wages for decades while CEO compensation rose from 20 times the typical worker's compensation in 1965 to 270 in 2008. What could workers do? As film maker Michael Moore puts it, they could throw Molotov cocktails at the powers that be. Trump was their Molotov. Similarly, in the 2016 referendum in the UK, those who felt left behind tended to vote for Brexit.

Union power

In centralized labour markets, disgruntled workers have an additional outlet for their frustration. United, they can demand wage hikes in an attempt to increase their share of national income. If employers do not accede to the unions' demands, strikes will ensue. When peace is restored in labour relations, inflation will have taken its toll as was common in the

UK as well as on the European continent in the past.

Iceland today is a case in point. Its labour market legislation has remained unchanged since 1938. Labour unions retain an undiminished ability to dictate wage increases in the belief that the government will come to the employers' rescue if necessary by allowing the currency to depreciate. In the past, the unions used this power frequently, which helps to explain why Iceland has had the second highest average rate of inflation in the OECD region since 1960, after Turkey. Under new leadership, the unions may want to throw their weight about the political arena. They can be heard saying: It's our turn to eat.

Side by side, the political class and the business community in Iceland have jeopardized the economic recovery from the 2008 financial crash by granting themselves excessive wage hikes, thus triggering competing wage claims that threaten to reignite inflation. Wage earners who bore the brunt of Iceland's painful recovery were not amused when the salaries of MPs were increased by 111 percent from 2011 to 2018. Ordinary wage earners, now instructed to reconcile themselves to a four percent increase in upcoming wage negotiations so as 'not to endanger macroeconomic stability', are not about to cave in. They hear John F. Kennedy saying: "You cannot negotiate with people who say what's mine is mine and what's yours is negotiable."

The employers and the government defend their position by claiming that Iceland's earlier equality of after-tax incomes and wealth as reported by the OECD has been more or less restored since the crash. This line of defense is weak because capital gains are still excluded from the OECD's Gini index. Moreover, Iceland's disproportionate presence in the Panama Papers suggests that large amounts of Icelandic wealth are still likely to be hidden. Last but not least, no one claims to know what became of the loot from the 2008 crash, an issue that is not confined to Iceland. Increased inequality, especially when amplified by graft, can have serious consequences.